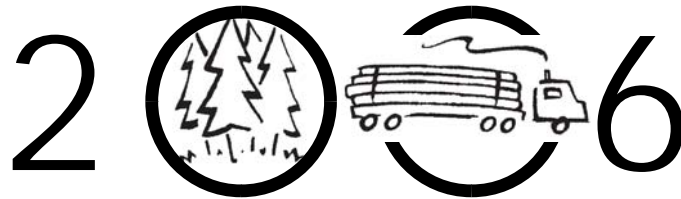


HJR 33 Study of Contract Timber Harvesting



A report to the
Environmental Quality Council
60th Legislature

The contributors to this paper
can be found in Appendix B

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Executive Summary

Some states, such as Washington, have shown that contract logging and direct marketing of forest products can expand the customer bidding pool for state timber and yield an additional 10% to 20% in revenue to the state compared to the traditional method of selling timber stumpage.

In addition to potential revenue increases to trust beneficiaries, this nontraditional approach of contract logging and direct marketing of forest products provides other benefits, such as additional flexibility, control, and more predictable results, where limited markets exist and in managing environmentally sensitive areas.

During the 2005 legislative session, Senate Bill No. 96 was introduced to provide the Montana Department of Natural Resources and Conservation (DNRC) the authority and flexibility to directly contract with logging firms to harvest timber on state lands and then sell those harvested materials to forest product companies.

After passing the Senate, the bill was converted in the House to a joint study resolution (HJR 33) because of concerns raised by some in the forest products industry. The purpose of the study resolution was to assess the feasibility of implementing contract logging as an additional marketing approach to selling timber on state trust lands in Montana.

Contract logging has the potential to provide the DNRC more flexibility in meeting environmental requirements and to more fully market and capture both short- and long-term values for the trust beneficiaries.

Overall, the individual reports contained in this white paper support a limited contract logging program on state lands. The limitation would be in the amount of timber that

would be harvested under this approach, which would be up to 10% of the state's current sustained yield. Given the DNRC's mission statement and the fiduciary and stewardship responsibilities associated with managing these trust lands, contract logging has the potential to provide the DNRC more flexibility in meeting environmental requirements and to more fully market and capture both short- and long-term values for the trust beneficiaries.

Introduction

During the 2005 legislative session, Senate Bill No. 96 was introduced to provide the Montana Department of Natural Resources and Conservation (DNRC) the authority and flexibility to directly contract with logging firms to harvest timber on state lands and then sell those harvested materials to forest product companies.

After passing the Senate, the bill was converted in the House to a joint study resolution (HJR 33) because of concerns raised by some in the forest products industry. The purpose of the study resolution was to assess the feasibility of implementing contract logging as an additional marketing approach to selling timber.

The Environmental Quality Council (EQC) formed an interim subcommittee with broad representation to review contract logging issues and to conduct the study.

Attendees at the initial meeting represented state government, the Legislature, the timber industry, environmental groups, and public education.

The EQC formed an interim subcommittee with broad representation to review contract logging issues.

During the initial meeting on August 17, 2005, various subgroups were formed to explore specific issues or questions related to contract logging. These included: accountability, marketing, contractor (logger) qualifications, forest stewardship, economic impacts to local industry, log quality, and a “log sales vs. timber sales” analysis. Each subgroup was assigned to prepare a brief written report on one of the above topics and the associated positive or negative aspects of implementing a contract logging program. The individual reports were submitted to the EQC for compilation into an overall contract logging white paper. Therefore, this white paper represents a compilation of individual subgroup reports.

EQC Findings and Recommendations

Findings

- ❑ Contract timber harvesting can be a valuable tool that should be made available to the Department of Natural Resources and Conservation to effectively and efficiently manage forested trust land.
- ❑ Contract timber harvesting should be allowed on a limited number of board feet to determine its effectiveness and usefulness.
- ❑ Contract timber harvest has the potential of increasing revenue to the various trust beneficiaries, but carries additional risk to the trusts.
- ❑ Other western states have had success, in terms of increased revenue and better forest management, with the use of contract timber harvest.
- ❑ Contract timber harvest will provide an option for harvesting and managing timber in environmentally sensitive areas.
- ❑ The use of contract timber harvest will potentially provide access to timber sales to smaller businesses and more opportunities, resulting in higher income to the trusts and better management and health of trust land forests.

Recommendations

- ❑ The Department of Natural Resources and Conservation should conduct a cost-benefit analysis on any contract timber harvest activity.
- ❑ Legislation should be drafted and presented to the 2007 Legislature to allow the Department of Natural Resources and Conservation to conduct contract

timber harvest on an amount of timber not to exceed 10% of the sustainable yield volume.

Chapter 1: Forest Stewardship Sales Under HJR 33

The Montana Department of Natural Resources and Conservation (DNRC) has undertaken a study to determine the feasibility of contracting the harvesting of timber through a direct contract between the DNRC and the logger. The DNRC, through a bidding process, would then sell the logs to various purchasers based on price and a purchaser's required log specifications. In addition to commercial harvesting of green and salvage sales, there are some forest stands on state trust lands that require a harvest treatment of some type to:

- (1) reduce stand densities (overcrowding) and facilitate better tree growth;
- (2) address significant outbreaks or chronic insect and/or disease problems;
- (3) reduce the potential for large stand replacement type wildfires; and
- (4) reduce understory trees and brush to promote the regeneration of historically present species.

These types of forest stewardship projects generally involve working with timber that is too small to be commercially valuable. In stands identified for potential forest stewardship treatments, overcrowded stands result in many small trees that are stunted because growth has slowed or stopped because of the severe competition for limited nutrients, water, and sunlight. Trees in these overcrowded and stagnant stands are not growing as they should and are very susceptible to severe fire, windthrow, insect, and disease problems. These dense stands are susceptible to complete loss. Forest stewardship treatments are meant to address the issues noted above and to restore a stand to a more ecologically viable state. Typically, treatments would involve removal of a majority of the trees in a stand, thereby allowing the remaining trees to release and begin to grow and develop into what would become a more fire resistant, healthy, diverse, and eventually commercially viable stand of trees. Treatments would follow a silvicultural prescription or management plan prepared for each project. These types of forest stewardship treatments are beneficial in terms of being timely, economical, and practical.

The wood that is removed would typically be of small diameter. Historically, these wood products would be of little to no commercial value and would be either left in woods or possibly used as pulp. However, wood processing technology has changed over the last decade to where some mills in our region are able to use this material to make commercial products, such as lumber and particleboard. Although small diameter wood is still economically marginal at best, trees of this small size can now be used as part of a mill's overall production process. Developing a method for taking advantage of this new industry ability is one reason why forest stewardship programs were created and why they have continued.

A contract logging program has the potential to give the state another set of tools that it can use for treating various types of forest health issues on school trust lands.

The Washington Department of Natural Resources (WADNR) has implemented forest health improvement projects as a part of its contract logging program. This was authorized by the Washington Legislature in 2004. This aspect of the program was created to address forest health issues, such as stagnant stands of

trees, wildfire risks, insect and disease outbreaks, ice storms, and wind events. The legislation also allowed specifically for silvicultural treatments to improve forest lands, thereby increasing both forest productivity and returns to the school trusts. The legislation gave the WADNR the ability to apply proven and experimental silvicultural treatments to specific stands that were considered in need of treatment as long as the management proposed was consistent with state laws and any applicable management plans. The Legislature also noted that material harvested under the forest health program would not be included as part of the annual harvest under the WADNR's calculated annual sustained yield, although the legislation did limit the amount of annual harvest to a maximum of 10% of the calculated annual sustained yield. The legislation also gave the WADNR the authority to sell the products from these contract logging projects below the calculated state minimum bid values as a way of attracting potential bidders for products with low potential returns. The WADNR program, while still relatively small, is working very effectively, especially on

Washington's eastside forests, which are very similar to Montana's forests. Products produced from this program are selling and have received a positive response from industry.

The DNRC would adopt a similar forest health component to this proposed contract harvesting program if it were enacted. It would be patterned after the WADNR program in terms of permitting silvicultural treatments to improve forestlands, and it would act as a vehicle to authorize the DNRC to sell products generated from these types of management activities. The DNRC would limit the amount of lands treated under this program by including it in the contract logging program, which in total would be limited to a maximum of 10% of the calculated annual sustained yield for trust lands. However, volume that would be harvested under the forest stewardship aspect of the contract logging program would not be included as a part of the state's annual sustained yield harvest.

The DNRC would also sell products generated from these projects to the highest bidder but would be prepared to accept prices that may be below minimum bid levels if markets or other factors, such as transportation costs, required it. This ability to accept potentially low prices could be offset by the reduced costs of having to do other types of site preparation on these lands and through the reduced costs of burning smaller quantities of slash.

In summary, this program has the potential to give the state another set of tools that it can use for treating various types of forest health issues on school trust lands, and it can do it while still generating some income or reducing cost for the trusts.



Chapter 2: Log Marketing

Marketing logs would be similar to practices currently used to market timber sales. Logs would be sold as standing timber or in the deck, at a contractually agreed upon price, to potential purchasers via a sealed bid process. A bidder list would be developed similar to what is currently used to sell timber sales. The list would include any mills that wish to be on the bidders' list or anyone who may be interested in purchasing logs directly from the State of Montana. A key concept is to include micro or niche mills that may pay a premium price for a desired product. These mills have historically not bid on timber sales because of the unwanted product or added burden associated with a normal timber sale. The list would be reviewed and updated as necessary.

The process to market logs would begin with a cruise designed to create a list of potential products by species and volume. A prospectus would be developed identifying the different products and would be sent to potential purchasers. Potential purchasers would be notified and given a period of time to inspect the timber, and bids would then

The DNRC recognizes that its first duty is to the trust and would reserve the right to sell logs in a manner that benefits its fiduciary responsibility.

be submitted for the products that they wanted from the sale. For those products, bidders would specify acceptable log specifications, such as species, length, top diameter, allowable defect, minimum log grade, etc., that they require. Once the logs are sold, the state would hire a contract logger to cut, process, and deliver the specified product to the successful bidders. To determine loading and transportation costs, the state would use a schedule based on mileage and type of road, much the same as industry practices. This schedule assigns a cost per mile to hauling on various types of road surfaces and road grades that is then used to calculate an actual haul cost based on total haul distance. Therefore, all potential contract loggers would submit a bid for the harvesting and processing. The haul cost would be set by

the state. A potential downside to this is that bidders would be making assumptions on log quality and may adjust bids accordingly to factor in that risk. The DNRC recognizes that its first duty is to the trust and would reserve the right to sell logs in a manner that benefits its fiduciary responsibility. This means that a mill that may be willing to pay a higher delivered price may not be the winning bidder because of associated transportation costs.

Under this program, logs could be temporarily held back from sale. This tactic could allow the state to capitalize on short-term market trends. Relatively high stumpage values have been received by the state because it consistently puts sales up for bid throughout the year and the wood is typically higher quality or includes species and sizes of trees not typically found in other venues by potential buyers. The program would give the state the ability to plan sales of particular types of products based on spot market conditions and emerging trends in prices. This would be done carefully and with a thorough risk analysis behind any decision to pursue a given market by delaying a sale. The marketing concept is expected to generate increased revenue for higher valued products, but there are also areas, such as fuel reduction treatments, where the benefit may not be in increased revenue but a more desired stand condition that will result in increased future revenue generating potential.

In order to keep industry contacts current and consistent and to keep on top of the market, a forester would be designated to be responsible for overall management of the program from the field aspect. The forester and Forest Management Bureau would create and update the bidders' list for both log buyers and loggers interested in contract harvesting. This field representative would work closely with unit foresters and play a pivotal role in marketing logs and in ensuring that all aspects of the program are accounted for. As the program progresses, the forester responsible for oversight, in cooperation with unit foresters, could attempt to maximize revenue by actively seeking higher valued products closest to those mills paying the higher prices.

The benefits of having a log marketing program are expected to be:

- (1) increased revenue of higher valued products;
- (2) potential for revenue generation in areas where a standard timber sale likely may not sell because of unusual circumstances or an undesirable product mix;
- (3) potential benefit to smaller mills and niche markets that realistically did not have a chance at securing state timber;
- (4) public may be more receptive to state-controlled logging;
- (5) state may be able to do a better job controlling logging in more sensitive areas by hiring loggers based on proven performance;
- (6) reduced preparation workload on field by hiring proven loggers;
- (7) ability to capture some revenue from low-value material that is often currently wasted. (Example: pulpwood from culls and tops or additional tons of small roundwood for other uses, such as hogfuel or added products.)

In summary, a log marketing program is expected to be worthwhile for the state. The program may or may not generate a substantial increase in revenue but, in certain circumstances such as fuel hazard reduction or forest improvement, may be a valuable tool for the state to obtain other worthy objectives and improve the future income generating capacity of the land.



Chapter 3: Log Sales Accounting

One of the key aspects of making this system work to the benefit of the state, and therefore the trusts, would be to have an accounting process in place that would work under field conditions for tracking both the logs and the payments. There are a number of aspects to properly account for all of the expected costs and revenue associated with a log sales program. It would be important that information be reliably entered into an accounting program as it is generated—in other words, as funds are collected and spent, so that costs and benefits can be assessed throughout the process.

One of the key aspects of making an accounting system work is to have a process in place that would work under field conditions for tracking both the logs and the payments.

The system that the state currently has for tracking costs and revenue is the Trust Land Management System (TLMS). The TLMS has a forest management module designed to track revenue and logs or loads of logs from a timber sale. This system could easily be modified to also allow entry of associated costs to any particular project, such as harvest costs, road maintenance, overhead, etc.

Logs to be sold would be tagged, either individually or by lot, with a truck ticket. This is a three-part ticket with a unique number that can be used to track the various products from the harvest site to the mill as well as through the TLMS. This tracking methodology is currently being used for the timber sale program, and it has worked very well. It is user friendly and allows the ticket to be tracked by sale, date, location, product type or sort, invoice number, purchaser, and ticket book. The TLMS can handle log sales based on tons or MBF (thousand board feet, Scribner scale). This would facilitate tracking because both systems of measurement may be used on a sale (for example, board feet on sawlogs and tons for pulp).

To facilitate smooth field operations, the state would supervise all harvest and processing operations. The state would contract with a logger and would guarantee through contract and contract administration how the logging would be done and, more importantly, how the logs would be processed as far as meeting purchaser requirements for length, diameter, defect, and so forth. Payment for the logger and other directly associated costs would be paid out of a revolving fund that would be created as a part of the authorizing legislation. All revenue collected under this program would go into this fund, and direct costs would be paid out of this fund. A balance sheet would be maintained within both the TLMS and SABHRS systems. State employee wages and benefit costs would not be paid out of this fund. Costs that would be paid include logging, decking, sorting, loading, hauling, any directly associated road construction or road maintenance costs, and forest improvement (FI) fees. FI fees would be assessed to the purchaser for all sawlogs purchased. FI fees are not collected on nonsawlog products. This fee is set annually and is assessed, by statute, on all sawlogs harvested off of state trust lands. The fee would be published in the announcement for bidding and would be collected concurrent with the payment for the logs. Annually or on a specified timetable, the revenue within the revolving fund would, except for anticipated operating expenses, be allocated to the various trust accounts. This allocation would be based on volumes of timber purchased from the various trust funds. The TLMS would, through the legal description of the harvested lands, identify the trusts that are associated with each sale, and the funds would be attributed accordingly. A set and equal percentage of money would be held out of each distribution to cover operating expenses.

Each purchaser would sign a log purchase agreement (contract) for each particular sale from which logs are purchased. Quantities and sorts purchased would be listed in the contract. The contract would spell out the log specifications and would include penalties if the specifications were not met on a certain percentage of the delivered logs. Penalty language would be based on the type of product purchased.

Payment for all logs purchased would be required within a predetermined time period after the notice of award has been made and the log purchase contract has been

signed. Bid deposits would be required. Logs would not be removed from the sale area prior to receipt of payment. Advance payment is required by statute. A schedule specifying amounts and timing for making payments would be part of the agreement, or 100% of the bid amount would be required to be paid before any logs are cut and/or delivered. Payments can be made and credited in the TLMS at the unit, land office, or bureau level. Payments would typically be made directly to the bureau, at the unit office, or through the forester in charge of the field program.



Loading lodgepole pine logs, 1956
Lewis and Clark National Forest
Photo courtesy of the U.S. Forest Service

Purchasers would be required to return the truck tickets, with their associated weights, within 2 weeks of hauling the logs. The state would use this weight information to determine the actual weight and therefore the actual revenue for products sold by the ton. A final billing would be prepared by the state to settle and balance each log purchase agreement account. Truck tickets and weights for logs sold on a per thousand basis would also be collected. For logs sold on a per thousand basis, weight and scale information would be used to determine actual revenue. The state may accept mill scale or scale logs using state personnel or contract scalers. Only weights from certified scales would be accepted.

Total weight harvested may also be used by the state as the basis for paying the logger. The majority of logging and woods processing contracts in Montana are on a per ton basis. This is an accepted way of doing business. It is in the best interest of the state to pay by the ton because of products that would be required to be removed, such as pulp or posts and poles, that cannot easily be measured in MBF.

Loggers hired by the state to harvest and process logs on these projects would be required to secure a performance bond before their work begins. The amount of the bond would be set either prior to negotiating with a particular logger or before the work is put out for bid. The bond may be from a bonding company or be cash or a letter of credit, or a small amount may be paid up front and then a specified amount withheld from each payment to the logger, which would be applied to the bond. The logger would also be required to have and provide proof of liability insurance, vehicle insurance, and workers' compensation insurance.



Chapter 4: Log Sales Versus Timber Sales

Introduction

Amid reports that sales of logged products instead of sales of standing timber or cutting rights produce more income to landowners, the DNRC has launched an investigation into the possible adoption of the sale of logged products instead of the sale of stumpage. Product sales would necessitate significant changes in the contractual arrangements between state forest managers and the companies that log and purchase wood products from them. These arrangements might be categorized as clauses that:

- (1) disperse risks between parties to the contract;
- (2) specify how the products will be measured;
- (3) specify timing for such things as contract award, product removal, and payment; and
- (4) define the various products being sold in clear, unambiguous ways (sawlogs, fence posts, peeler logs).

The Envisioned Change in Policy

Rather briefly, the sale of products would occur in the following way. The state would manage two or more contracts in place of the standard timber sale contract: a logging contract and one or more product sale contracts. The bidder who acquired the logs prior to logging would specify how the logs are to be cut into products and the price to be paid for each type of log. The logger would be paid on a per ton basis to harvest the sale area and

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yard the logs to landings. In a standard timber sale contract, the buyer specifies how much the buyer will pay for the logs and payment is based on the volume (tons) removed. The purchaser is liable for all of the sale development costs.

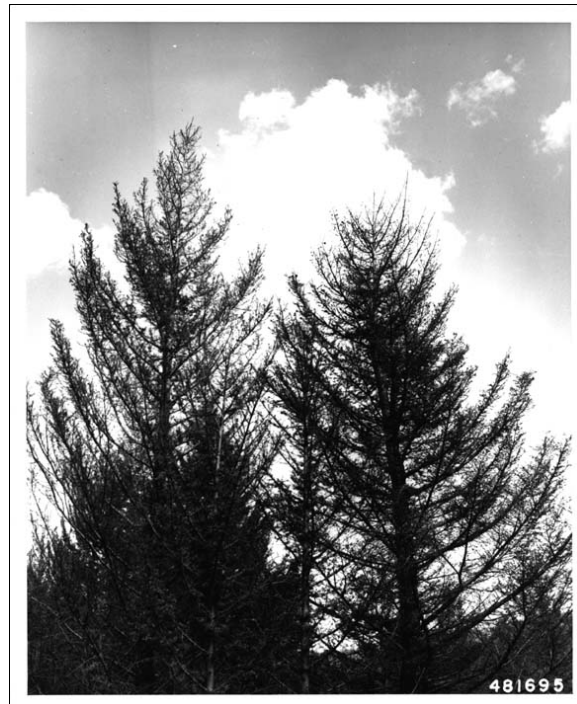
Risk and Value

The general view of timber and log purchasers is that they are risk averse. That means that they are willing to pay more for contracts with lower risk than those with higher risk. Standard timber sale arrangements disperse risks in a variety of ways. Scaling or payment for the actual volume removed reduces the risk for sampling errors inherent in presale cruise volumes or in estimates of wood defect. Some contracts are “lump-sum” in nature. Here, the purchaser bears risk if a sale cuts out short. (Sellers that use lump-sum contracts often spend more money increasing the accuracy of sale volume estimates with more intensive sampling.)

Some contracts have price escalation

clauses or automatic adjustment in stumpage prices in accordance with changing market prices, which occur after the contract is awarded and prior to removing the logs. Here, the buyer and seller share the risk for changing market prices.

Arrangements such as these will typically increase stumpage prices over contracts without escalation clauses. Risk is also dispersed by a variety of contract clauses. For example, title to timber may change at the time of felling. Thus a forest fire that consumes decked logs produces a loss to the buyer, while one that destroys standing timber in the sale area creates a loss to the seller. The time requirements for timber sales can also affect value. For example, if a timber purchaser acquires



Defoliation from Spruce Budworm
Gallatin National Forest
Photo courtesy of the U.S. Forest Service

timber in a weak market but has several years to complete logging, the opportunity to capitalize on future market conditions can easily affect the bid. Short-term contracts don't allow bidders to capitalize on future market conditions. In addition, short-term sales may make it more difficult for mills to orchestrate their supplies.

If the DNRC adopts product sales, it would necessarily change the risk parameters for the wood being sold. In some cases, there would be less risk for purchasers, and in other cases, there may be more. Buyers would be more assured of the product content of the forest after timber is felled and bucked than before felling. However, once the logs were felled, there would be greater concern with getting the products out of the woods to avoid loss because of insects and decay. Buyers may not be able to time logging with market conditions or to meet particular supply concerns of individual mills or purchasers. At the same time, buyers of felled products would not take on the risks associated with logging because of weather, terrain, and errors in logging costs estimates. The WADNR apparently puts a lot of effort in the cruise estimates for its product sales. There could be some training and manpower development needs to do the same here in Montana. More intensive cruising would increase sale preparation costs.

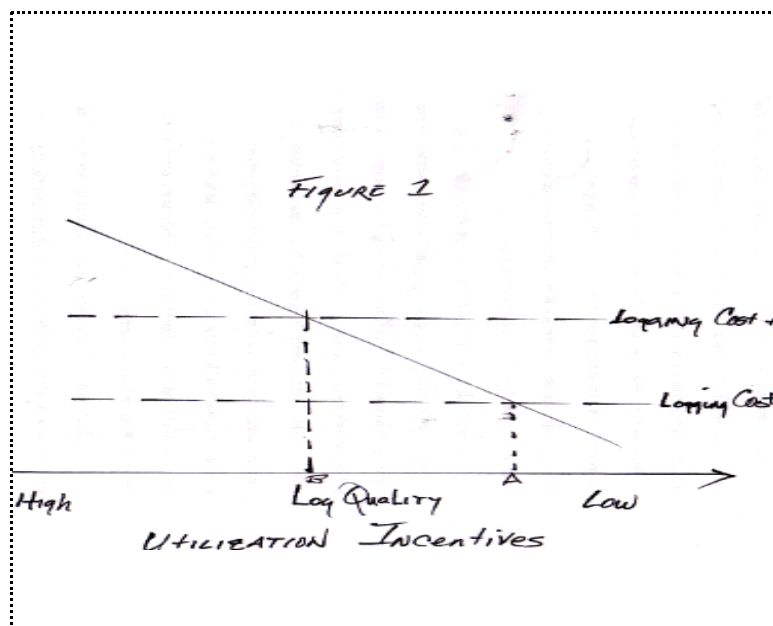
Products Measurements and Value

Forest managers are now working with a number of products measurements. Post and pole yards buy material by the piece with measurements based on small-end diameter and length. Some purchasers and sellers are working with weight measurements for roundwood products, while others are working with board-foot measures or even cubic-foot measures. A variety of factors seem to be influencing the changes in measurement units. Harvested trees are smaller in size than was the case a few decades ago, and log scalers are not as readily available as was the case in the past.

The board-foot measure was designed to give a good indicator of the commercial content of a log. It was developed to facilitate trade and, no doubt, helped develop

the markets for timber. Buyers could easily estimate the product yield of standing timber. In recent times, this has meant the estimation of “overrun” because a thousand board feet of standing timber is typically converted into more than a thousand board feet of lumber or related products. The Scribner log measure used in Montana was developed for much larger timber than is common today. That is one key reason behind the overrun phenomenon. The DNRC currently cruises in board feet but sells by the ton by using board feet per ton conversion factors. Log purchasers have to estimate the quantity and quality of the finished products, which will be produced by their mills, in order to bid on logs or standing timber. There may still be overrun as a result of the conversion factors.

Changing to product sales from stumpage sales would change the way that buyers think about measurements. Currently, the buyer must estimate the finished product yield (lumber, chips, veneer, and so forth) from standing timber. Under the proposed policy, the buyer must anticipate how the logger will cut to the buyer's specifications and then estimate the finished product yield. Although this point may seem subtle, the proposed policy changes the log use incentives. A brief look at figure 1 should help clarify this point.



Log value is a diminishing function of log quality. Log value is rather complex and is really a multidimensional phenomenon, but the major factors are diameter, form, and defect. The lower horizontal line represents logging costs for a given unit in a timber sale. If, for example, the logger is paid \$20 a ton to put logs in a landing, the logger will put all of the material in the landing that costs less than that to fell, buck, and yard to the landing. This is represented at point A on the graph.

The point of marginal use efficiency under the current policy is represented at point B. When buying stumpage when the buyer is liable for logging and pays for stumpage based on a scale, the cost to the purchaser is logging cost plus stumpage price. Here, any volume of logs lower in quality than B will cost more to acquire than they are worth. That is why the cutting or bucking specifications are so important to stumpage purchasers. As a result of the changes in use incentives, it is reasonable to expect that product sales would yield higher volumes of timber removed but that the average quality would be lower.

Under the current policy, timber purchasers typically instruct loggers how to cut out a sale. No two purchasers will typically create the same log mix out of a given stand of timber or timber sale. Mills have different requirements at different times. Bucking instructions are another way of “economizing”. Product sales would take away this form of economizing from the product buyer and put it in the hands of a third-party logger. (It is assumed that logging would be done by a third party, although there is no reason to believe that a product buyer may not also acquire the logging rights.) If the logger is paid by the ton (a piece-rate contract), there would be greater volume cut from an area than would be the case of a scaled sale. The value effects resulting from shifts to product sales from stumpage sales associated with product measurement seem to be countervailing. A logging contract with payment to the logger based on the piece would result in more logging volume. Contrarily, when the product buyer would have produced a different mix of logs when buying stumpage, loss of the option to buck at the product buyer's discretion, other things equal, would reduce the average value of the timber.

Shifting from current policy would affect bidding in another way. Under current bidding arrangements, bidders distribute their bid prices among classes of species. For example, if there are two species on a sale, the bidder places a bid on the estimated volume of each species. Even if there is a small cruise error on the total volume (total population), there will necessarily be a larger sampling error on each subpopulation. It pays bidders to increase the accuracy of the sale volume estimates on each species class so that they may place any overbid on the species that would short scale, thereby minimizing the amount that they will actually pay for the timber. Selling products by a bid on each class of products would potentially remove this buyer strategy.

Measurements—Just What Is a Stud Log Anyway?

A number of categories have been developed to describe timber and wood products. Those categories include things like: “number one sawlogs”, “peelers”, “studlogs”, “pulpwood”, “houselogs”, “posts”, “rails”, “utility poles”, and the like. The lines that separate these groups of products are rather fuzzy at best (certainly hard to decipher from a computer keyboard). Yet that is what a state forester does with a timber sale—create these product categories. A timber sale can yield an endless mix of products, and how these products are “imagined” will affect the total sale value. There will be some who will argue that the sale should maximize the volume of products. (Yes, Gifford Pinchot is alive and well in the DNRC.) There will be those who argue that the product mix should maximize the return to the trust fund (while at the same time



Forester measuring tree diameter, 1972
Lewis and Clark National Forest
Photo courtesy of the U.S. Forest Service

leaving the good old growth for the birds!). In order to do all of this, the state will need product prices and some kind of alternative product yields as well as a model to maximize the revenue of the sale by cutting into the right product piles. Appraising a product sale may take quite a bit of doing.

Evaluating Product Sales Versus Stumpage Sales

There are several things to consider in evaluating the adoption of product sales instead of stumpage sales. First, there are some of the pitfalls to evaluation.

- Pitfall 1. Higher average prices do not necessarily mean higher returns to the trust.
- Pitfall 2. Higher cut volumes do not necessarily mean higher returns to the trust.

Each of these points deserves more discussion. Stumpage price or the price paid for standing timber is a blended price. For example, if a buyer bids and pays \$200 per thousand board feet (or \$25 a ton) for the Douglas fir in a timber sale, the value reflects what the bidder is willing to pay for all of the Douglas fir removed from the sale. Some of the logs are worth more than others depending on size, logging system employed, yarding distance, and wood quality. The seller can influence the price paid for stumpage by making decisions about merchantability (log length and small-end diameter specifications) as well as what trees to include in the sale. ("What happens to the price if a helicopter unit is left out, or what happens to the price if the trees are thinned from above or thinned from below?") The buyer of stumpage can influence what the buyer pays by managing the cutting specifications. For example, cutting a tree into longer logs may reduce the value of each log but increase the total volume used.

In comparing sales of standing timber with sales of logged products, *the state must make sure that it is making valid comparisons*. Comparing average net income per ton from product sales contracts (product sales income per ton less logging costs per ton) with stumpage prices per ton is not a valid comparison. *Even if the same trees*

were sold, would they be logged and cut in the same way? To put it another way, the DNRC must make sure that it doesn't create an operation in which it changes the mix of products in a way that adversely affects the return to the trust by increasing the pulpwood harvest at the expense of some other more valuable products.

Because the state would pay for logging on a per ton basis, any increase in use would necessarily result in higher total logging costs over current stumpage sales arrangements. Payment per ton is a piece-rate contract, not a flat-rate contract. The logger will get paid for the amount of wood placed in the deck. The use incentives should result in a greater volume logged even if the log buyer sets out the cutting specifications. Because the buyer will again pay a blended price for each product class, the higher volume will not necessarily produce more sale income. Net sale income will increase only if:

- (1) the volume increases without a change in net value;
- (2) the net value increases without a change in volume;
- (3) the percentage increase in net value exceeds any percentage decrease in volume;
- (4) the percentage increase in volume exceeds any percentage decrease in net value.

Finally, the other perhaps more subtle point regarding the evaluation of product sales versus stumpage sales revolves around the manner by which the DNRC forestry is budgeted. Currently, a significant portion of the DNRC budget comes from earmarked funds from the timber sales. If the state experiences higher costs in managing product sales as opposed to stumpage sales, these higher costs could eventually be passed to the trust beneficiaries through higher earmarked funds. That could mean that gross income may increase without net income necessarily increasing. Thus the true acid test for evaluating product sales is the impact on net income to the trust beneficiaries.

Conclusions

The DNRC has a constitutional duty to investigate ways to increase returns to the various land trusts that it manages. Selling products instead of standing timber may prove to be a better source of income. There may be more competition for various product groups than for standing timber. There may be fewer risks to buyers for product sales than for standing timber sales. At the same time, there may be new risks associated with product sales. Furthermore, the evaluation of the revenue aspects of product sales is not an easy proposition because there may be changes in use and price as well as changes in the costs of managing product sales versus timber sales. As a result, a careful set of pilot sales should be studied carefully before there is a broad adoption of this method of timber disposal. This approach to timber disposal would increase the returns to the trust fund. However, there are pitfalls, and the state should do a good job in evaluating some pilot sales before making a permanent shift in policy.



Chapter 5: Economic Impacts to the Local Industry

The DNRC is seeking legislative authority for the ability to conduct contract logging and direct sale of logs on a portion of its annual sustained yield. The current annual sustained yield is 53.2 MBF. Currently, this volume target is met entirely through the traditional sale of stumpage from state trust lands. The DNRC is seeking the flexibility to sell up to 10% of this volume (approximately 5 MBF) through a contract logging/direct sale of logs approach. When viewed in the context of the annual statewide harvest of approximately 700 MBF, the proposed 5 MBF that could be harvested using the contract logging approach represents approximately 0.75% of the annual statewide timber harvest level. Given this scale, the economic impacts to local industry are likely to be minimal.

Although the economic impacts to local industry are likely to be minimal, the perception or relevance of these impacts will depend on the individual views of those likely to be affected. The most likely parties to be affected are identified below along with potential impacts.

When viewed in the context of the annual statewide harvest of approximately 700 MBF, the proposed 5 MBF that could be harvested using the contract logging approach represents approximately 0.75% of the annual statewide timber harvest level.

(1) Contract Loggers – These are loggers who contract only with log and/or landowners to harvest their timber, but do not market the logs from the sale. The logger is paid a per unit rate (dollars per MBF or dollars per ton) for harvesting, processing, and sorting the logs at the harvest site but is not involved in the transportation or marketing of the logs to various mills.

Under the contract logging approach, contract loggers must be able to qualify for state logging contracts. Qualifications may include but are not limited to bonding, workers' compensation, liability insurance, performance criteria, equipment mix, etc.

The contract logging approach may be an additional source of contract revenue and profit for qualified loggers who can operate efficiently within the DNRC's sale requirements. The contract logger would be able to submit a bid to be paid for harvesting operations and possibly transportation costs for hauling sawlogs to various mills.

(2) Independent Logging Contractors (Logger – Purchaser – Contractor) – This includes loggers or purchasers who log the sale themselves and then broker, or market, the logs to various mills, specialty operations, or manufacturers.

In the initial startup of this approach, some of these individuals may be sought as consultants to help the DNRC establish efficient ways of setting up the contract logging/direct sale of logs program. Some may view this as direct competition, while others may view it as a business opportunity and additional source of income. However, the relatively small amount of volume (5 MBF) that the state would put up for sale each year using this approach is likely to have minimal impact on these individuals.

(3) Log Brokers – These are individuals who either purchase logs from various loggers and then market the logs to a variety of mills or have a contractual arrangement with various loggers to market their logs to a variety of mills for a fee or percentage of the sale. Because some loggers and most small private landowners choose not to market their own logs, they may elect to use the services of a log broker.

Some log brokers may view the proposed direct sale of logs by the state as being in conflict or competition with their services. However, after a preliminary review, it does not appear that many or any state timber sales or permits are sold to log brokers. Mills and independent logging contractors purchase the

vast majority of the state's sales, so the impact to these individuals is expected to be minimal.

(4) Log Processors – This includes various mills or manufacturers who process and convert round logs into another form (lumber, pulp, house logs, beams, etc.) for intermediate or final use by consumers.

These facilities currently buy state timber sales and then contract with a logger to harvest the timber sale according to its specifications. The mill that purchased the timber sale uses the logs that meet its preferred product specifications (logs that its mill or facility is designed for). The logs that do not meet its specifications are either shipped to another facility owned by the company or sold to another mill. Most mills remarket or sell unwanted logs as a part of its revenue/profit stream. Mills that remarket or sell a considerable amount of unwanted logs may view the state's proposed direct log sale approach as cutting into its profit margin. However, some mills or specialized facilities may view it as a benefit to purchase only the logs that they want, thereby avoiding the costs and headaches of handling and remarketing unwanted material. Again, the impact to any specific mill is likely to be minimal because this direct marketing approach would involve only 5 MBF spread throughout the state.

(5) Industries that directly or indirectly support the forest products industry – This may include indirect impacts on such entities as truckers, equipment dealers, service vendors, welders, local shops, and others.

The local economy of any given area would likely see little difference with the proposed implementation of the direct sawlog marketing approach. Local businesses would still provide much of the same materials and services no matter who directed the harvesting and sale of the sawlogs. The companies actually doing the harvesting work would likely use the same local services and support.



Chapter 6: Log Quality and Quantity Considerations

The DNRC has undertaken a study to determine the feasibility of contracting loggers to harvest and process timber from state trust lands and for the state to then directly market the logs to various mills or outlets. This portion of the study attempts to identify potential log quality and quantity concerns expressed by some members of the forest products industry.

There are a number of issues and concerns that potential purchasers of state-processed logs have identified in terms of making sure that they get what they have bid on and paid for. This may affect the revenue generated by this type of sale because all of the issues listed below could influence the price that a potential bidder is willing to pay. The DNRC will need to consider and address these issues during the bidding process as well as throughout the harvest operations.

The eight issues raised by some industry representatives are summarized in Section A below. Section B contains information on how the WADNR has addressed some of the issues and the potential solutions or options considered by the DNRC.

A. Issues/Concerns Raised by Some Industry Representatives

(1) Purchasers of logs from direct sales have no control over the timing of the delivery of logs and/or the specific log manufacturing requirements of those logs. Timber sale purchasers (manufacturing facilities) prefer to control their own log delivery schedules and to merchandise the logs to their own specific facility needs and specifications.

(2) As a general rule, state foresters administering the direct log sales have little to no understanding of the specific needs of individual mills or plants in regard to manufacturing their respective product. In comparison, foresters employed by the individual purchasers administer their contractors or dictate

to their suppliers the exact merchandising specifications required by their facility.

(3) In Washington, the WADNR selects the lowest bidder or “best bid”, which is often a contractor from a different region of the state than the sale location and the manufacturer purchasing the logs. This contractor frequently has no idea what type of product or the specifications required by the purchaser in the area of the timber sale. The purchaser of the logs is at the total mercy of the state forester to have the logs merchandised to the purchaser's desired needs. This concern by purchasers has led to a discount on stumpage bids for the logs in Washington.

(4) There is a concern among purchasers of what type of system the state would use to determine payment for the products from these direct log sales. A “Third Party (bureau) scaling” system as used in Washington would be prohibitively expensive in Montana. The state would need to work out some type of equitable measurement system for stumpage that works for both the state and the purchasers.

(5) All mills would scale logs and have length, top diameter, and quality deductions as well as culls. With loggers getting paid by the ton, they would get as much on the truck as they think they could get away with. Montana loggers already do that, and one even owns part of a mill! How will this get reconciled with the tons that the state expects to get paid for? Do mills use their weight factor or the state's? Will mills be expected to hold loads for a state scaler or sale administrator to review?

(6) Mills have problems with missorts, and it seems that the likelihood for this will be greater with more sorts. Do logs get held and returned or processed at some default sales price? Do they have to get held until logger, hauler, and/or sales representative can verify a missort? How does the purchaser interact with the logger and/or hauler when there are problems?

(7) Trucking has become a huge issue—too many loads to move and not enough trucks to get it done in a timely fashion. The increase in trucking costs has exacerbated the problem. What steps will the state take to ensure that logs are moved prior to quality problems arising, i.e., bluing in lodgepole and ponderosa pine in the early summer? Pyramid's default price for blue pine is about half of green price. Will all green lodgepole and ponderosa contracts have provision for blue logs?

(8) Will there be a guarantee by the state of the advertised volume estimate? It is very difficult to plan for a log delivery schedule at individual manufacturing facilities if the volume estimate is unreliable.

B. Washington Department of Natural Resources and Montana Department of Natural Resources and Conservation Considerations

(1) The WADNR has addressed this concern through its adoption of a 6-month price commitment for accepted bids. This gave purchasers some assurance as to when their logs would be delivered. The WADNR also wants to harvest and market logs within a reasonable timeframe to be able to respond to changing markets and meet contract commitments.

One approach considered by the state is to sell logs as standing trees and then process the logs. When standing timber is sold, the bid submitted by potential purchasers would contain their preferred cutting specifications for the particular log sort offered. A sort is derived basically from a set of specifications. A log would need to meet all of the specifications to be included. These specifications are typically species, diameter, length, amount of defect, straightness of grain, and number and size of limbs. Allowing purchasers to specify the manufacturing requirements would give bidders a higher degree of comfort that the logs that they are bidding on would be processed to their requirements. The state would incorporate these specifications as part of the log purchase contract between the purchaser and

the state. A priority system would be established whereby the highest value sorts would have preference over lower value sorts. As the sorts work toward lower value, the specifications generally get broader, allowing a wider mix of log lengths, diameters, defect, etc., to be included. This would compensate for the specific specifications of the higher value sorts and would prevent wasting of wood. These specifications would also be part of the logging contract between the state and the logger hired to harvest the sale. Quality control by the state would maintain a high percentage of logs meeting the preferred specifications. The state would also be responsive to changing purchaser requirements over time.

Log delivery schedules would be planned to stay concurrent with the harvest operations. Log purchase agreements would call for delivery of the purchased volume generally within 3 months of the effective date. The concern of those in the industry that they could not get logs when they want or need them may not be applicable because of the relatively small amount of volume involved and the ability of the state to closely monitor trucking schedules to meet contract obligations. This program would be limited to a maximum of 10% of the state's annual sustained yield harvest volume. Currently, that would provide a maximum of 5.3 MBF a year for the program. If the state were to harvest the maximum each year, it would amount to only approximately 0.75% of the roughly 700 MBF harvested annually in Montana.

(2) The WADNR has made and continues to make efforts to learn what customers want. It talks with mills in the general area of proposed sales and will modify a sale if necessary to make it more attractive to potential bidders. Its on-the-ground forester works closely with purchasers and the logger to make sure that logs are being produced to the purchaser's satisfaction.

A big part of this program would be keeping lines of communication open to mills, loggers, consultants, etc., so that the state can be responsive to industry requirements and changing market conditions. The state has several foresters

on staff with experience working directly for private industry and/or acting as consultants selling logs to in-state mills of all types. Most of these foresters have maintained or expanded their list of industry contacts since coming to work for the state. They are familiar with the quality control standards required by industry, and they would be expected to meet them as a part of this program. The forester chosen to head up this program for the state would be chosen based on experience and ability to do the job.

(3) The WADNR is addressing this problem by working very closely with purchasers to make sure that logs are being processed correctly. It believes that it is making progress because reaction from purchasers has been positive. It is also prequalifying contractors and is making efforts to have them committed to harvesting a particular sale within specified timeframes and to meeting quality control requirements.

The state intends to prequalify loggers for this program. Prequalified loggers would then have the opportunity to bid on each direct log sale project. The state would reserve the right to select the most qualified bidder based on price and other factors.

(4) The WADNR uses third-party scaling organizations to scale the logs. This is standard practice in the western Washington area. It does not plan on changing this approach unless industry standards change.

The state anticipates using a payment system based on tons. The state has successfully used payment by the ton for all of its timber sales for several years. Payment by the ton would follow the same process that the state currently uses. All loads of logs would be required to be weighed on state-certified scales. The empty truck is also weighed so that a true weight for the logs can be determined. Conversion factors, the factor to convert from tons to MBF, can be calculated for each product category as part of the state's timber sale cruise process. Past experience has shown that the state can calculate

conversion factors with a high degree of accuracy. Conversion factors would be assessed throughout the process to gauge accuracy and reliability.

(5) The WADNR generally doesn't have any problems with differences in scale because of the use of third-party scaling organizations.

Mills do sample scaling to determine the quantity and quality of the products that they are getting. The state would also have qualified quality control staff work with the sale forester to ensure proper log manufacturing and sorting. A cooperative effort between the purchaser and the state to assess log quality would allow the state to quickly address problems. In the event that there is a verifiable, significant difference between the conversion factors advertised by the state and the conversion factors determined by the purchasing mill, the state would negotiate a solution. To reduce these concerns, the state would have the mill's preferred cutting specifications, for each sort purchased, included as part of the logging contract. Also, penalties to the logger would result if the logger did not meet the requirements of the contract. Additionally, loggers would be vetted in the process described above, and this would help to ensure quality.

(6) Washington loggers are familiar with doing numerous sorts on a project. The loggers in the region have learned to handle multiple sorts, and their loader operators, or whoever is doing the sorting, will work with the WADNR and/or the log purchaser to determine which specific sort characteristics are critical to making proper choices when sorting logs on the landing. In these projects the WADNR sale administrator determines the specifications for on-the-ground sorting. There is a learning curve associated with this, but loggers in any given area are now expected to be familiar with local requirements. This is vetted through the contractor qualification process. The logging contractor is responsible for log missorts.

The state sale administrator would address the potential problem of missorted logs by working closely with the quality control forester, the logger, and the purchaser's representative. The state recognizes that it has the responsibility to provide the products specified in the log purchase contracts and would use the resources necessary to deliver those products. The purchaser's representative would be able to inspect decked logs at the representative's discretion prior to haul to ensure that they meet the purchaser's specifications. In this way, problems could be addressed quickly.

(7) Washington currently does not have a log truck shortage, and the typically maritime climate works to the WADNR's advantage when logs cannot get hauled in a timely manner.

Log truck availability would continue to be a function of the market. The state would not enter the trucking business, nor are any on-call agreements planned. The state would contract with a log hauling company, either itself or through the logger, to haul logs to the various purchasers' mills using standard industry practices. If a concern arose that log quality might deteriorate for certain sorts, the state would prioritize the log haul schedule by sort. The state would not pay over and above standard haul rates for the delivery of logs sold under this program.

(8) The WADNR completes the harvest prior to selling the logs. In this way, it can make an accurate volume estimate prior to offering the products for sale.

Depending on the approach taken by the state, the state would need to work with the forest products industry to address this issue and to find an equitable solution.



Chapter 7: Contractor Qualifications

When viewing the potential range of timber harvesting contractors that might have an interest in completing a *Statement of Qualification* (SOQ) for contract harvesting, the Montana Logging Association (MLA) estimates that there are well in excess of 600 independent logging contractors in the State of Montana that are engaged in the harvesting and transportation of logs from forest to mill.

Some contractors log, some haul, some log and haul while others are specially engaged in endeavors such as ground-skidding, line-skidding, helicopter-yarding, log-loading, road construction, or slash piling. Regardless of what kind of operations they perform, it is important to remember that the majority of these contractors are small business folks that operate family-owned businesses.

Therefore, it will be necessary to remember that the SOQ should not contain unnecessarily burdensome requirements that are often demanded of corporate entities or government bureaucracies.

The SOQ provided by the WADNR can easily be modified to meet the needs of the DNRC, and rather than duplicate its provisions in this report, it is recommended that it be the template for designing an SOQ for Montana.

Furthermore, the Accredited Logging Professional (ALP) program developed and administered by the MLA has qualifying provisions with respect to minimum levels of insurance, safety training and compliance, and environmental performance requirements—such as Montana’s Best Management Practices (BMPs) and Streamside Management (SMZ) law—that are also worthy of consideration.

This subgroup is not suggesting that participation in Montana’s ALP program be a qualifying requirement because there are some good logging contractors that have resisted participation. Nonetheless, training with respect to Montana’s BMPs, SMZ

law, and Hazardous Fuels Reduction Act must be included in the qualification process and required of all applicants.

The subgroup also suggests that “references” from forest landowners or agencies can be an effective way of evaluating a logging contractor's past performance and further suggests that compliance with all relevant provisions of the SOQ must apply to all subcontractors that are used by a prime contractor.

In conclusion, the subgroup believes that there is a sufficient cadre of timber harvesting professionals in the State of Montana to meet the needs of HJR 33 and, further, that there are sufficient programs in place in Montana and elsewhere to design a contractor qualification process that is fair, impartial, and balanced.



Appendix A

_____ BILL NO. _____

INTRODUCED BY _____
(Primary Sponsor)

BY REQUEST OF THE ENVIRONMENTAL QUALITY COUNCIL

A BILL FOR AN ACT ENTITLED: "AN ACT CREATING THE CONTRACT HARVESTING PROGRAM; DEFINING TERMS FOR THE CONTRACT HARVESTING AND SALE OF FOREST PRODUCTS FROM STATE TRUST LANDS; AUTHORIZING CONTRACT HARVESTING OF TIMBER AND FOREST PRODUCTS ON STATE TRUST LANDS; AUTHORIZING THE SALE OF FOREST PRODUCTS BY THE DEPARTMENT OF NATURAL RESOURCES AND CONSERVATION; CREATING A CONTRACT HARVESTING SUBACCOUNT FOR THE DEPOSIT OF GROSS PROCEEDS FROM CONTRACT HARVESTING SALES AND THE PAYMENT OF CONTRACT HARVESTING COSTS; PROVIDING RULEMAKING AUTHORITY FOR THE BOARD OF LAND COMMISSIONERS TO IMPLEMENT THE CONTRACT HARVESTING PROGRAM; AMENDING SECTIONS 77-1-613, 77-5-201, AND 77-5-204, MCA; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF MONTANA:

NEW SECTION. **Section 2. Statement of policy.** (1) The application of contract harvesting on Montana's trust lands provides an opportunity to improve forest health and long-term productivity, increase options for managing forests in environmentally sensitive areas, and provide potential revenue benefits for trust beneficiaries.

(2) It is important that the department has clear authorization and direction for conducting contract harvesting, including marketing and selling log sorts and other forest products.

(3) A clear funding mechanism addressing the receipt of revenue and payment for costs associated with contract harvesting projects provides the transparent process that allows beneficiaries to understand the costs and benefits associated with contract harvesting.

(4) Contract harvesting has the potential to result in increased bidder activity, better use and merchandising of products, improved harvesting results and environmental protection, and quicker completion of projects when time constraints are a factor.

NEW SECTION. Section 3. Definitions. As used in this part, unless the context indicates otherwise, the following definitions apply:

(1) "Contract harvesting" means a timber harvest or timber sale occurring on state trust lands by which:

(a) the department solicits bids and contracts with a firm or individual awarded the bid to:

(i) perform all necessary work to harvest and process trees into merchantable forest products;

(ii) sort trees pursuant to contract specifications and department use standards; and

(iii) transport and deliver the products to forest product purchasers; and

(b) the department sells the forest products to one or more forest product purchasers through the competitive bidding process pursuant to 77-5-201(1) and (2).

(2) "Contract harvesting costs" means expenses related to the production of log sorts or other merchantable products from a stand of timber and the transportation of the products to point-of-sale locations. These expenses may include but are not limited to:

(a) sale preparation and development costs;

(b) marketing of forest products and administration of contract harvesting contracts;

(c) road building and maintenance;

(d) labor for felling, bucking, yarding, and loading;

(e) scaling of forest products; and

(f) the transportation of sorted logs and other merchantable products from the harvest site to a point of sale.

(3) "Decked" means a pile of logs or other merchantable forest products that have been prepared for sale or shipment and placed upon a landing.

(4) "Forest health concerns" means issues that can be addressed through management or harvest of merchantable or nonmerchantable trees and includes:

- (a) forested lands that are overcrowded or stagnant and that are showing declining annual growth;
- (b) wildland/urban interface areas where timber harvest or forest management is necessary to prevent catastrophic or other damage to forested lands, livestock, buildings, or other infrastructure;
- (c) fire fuel buildup and treatment on forested lands;
- (d) forested lands susceptible to imminent or repeated insect or disease attack and timber degradation;
- (e) forested lands that are in a high state of decline or decay or are rapidly deteriorating;
- (f) forested lands with high recreational use and high degradation risk; and
- (g) forested lands under drought stress.

(5) "Forest products" means any product produced from the forest that the department can sell through competitive bid or direct negotiation.

(6) "Log sorts" means trees or portions of trees that are grouped and sorted into various product categories, including but not limited to pulp logs, saw logs, and house logs.

(7) "Saw logs" means merchantable timber prepared and sorted as decked, scaled logs and sold f.o.b., as defined in 30-2-319, at a designated location, expressed in terms of dollars per thousand board feet or dollars per ton.

(8) "Scaled" means the measured volume, weight, or other measurement of a log, load of logs, or other products.

(9) "Stumpage" means the value of timber as it exists, uncut, within a harvest unit, expressed in terms of dollars per thousand board feet, dollars per ton, or other appropriate value per unit designation.

(10) (a) "Timber" means any wood growth on state trust land, mature or immature, alive or dead, standing or down, that is capable of furnishing merchantable raw material used in the manufacture of lumber or other forest products.

(b) The term does not include cultivated Christmas trees.

NEW SECTION. Section 4. Contract harvesting authorized. (1) Under direction of the board and after submitting the various portions of the sale for bid, as described in 77-5-201, the department is authorized to sell timber and forest products from contract harvesting sales through the competitive bidding process pursuant to 77-5-201(1) and (2) and to contract with firms and individuals for the removal of timber and forest products from state trust lands, the preparation of those materials into merchantable form, the transportation of those materials to a point of sale, and other purposes that the department determines to be necessary.

(2) Except as provided in subsection (3), the department may not conduct contract harvesting on state trust lands in an amount greater than 10% of the annual sustained yield.

(3) (a) If the department is addressing forest health concerns as provided in [section 4], the amount harvested may not be counted against the 10% maximum provided for in subsection (2) and may not be counted toward the department's annual sustained yield level.

(b) The department may not exceed 10% of the annual sustained yield when conducting contract harvesting or management activities that address forest health concerns.

NEW SECTION. Section 5. Contract harvesting to address forest health concerns. All contract harvesting sales meant to address specific forest health concerns must be designed to:

- (1) improve the overall health, productivity, and long-term revenue potential for the timber stand;
- (2) be consistent with the state forest land management plan; and
- (3) comply with all applicable state laws, rules, and regulations.

NEW SECTION. Section 6. Rules. (1) (a) The board may adopt rules to implement the contract harvesting program. The board shall evaluate each proposed contract harvest to determine if, in the board's judgment, contract harvesting will fulfill its duty to prudently obtain the maximum long-term revenue for the trust beneficiaries or to address forest health or other environmental concerns.

(b) The board shall adopt rules describing the procedures necessary to ensure that the trust beneficiaries receive the full market value of the forest products.

(2) The board may adopt rules that impose specific appraisal requirements and sale procedures for any forest products directly marketed and sold by the department.

NEW SECTION. Section 7. Contract harvesting account -- authorized expenditures -- termination. (1) An account, called the contract harvesting account, must be created as a subaccount of the timber sale account established in 77-1-613, in which to deposit gross revenue and for the payment of expenditures associated with contract harvesting sales. All proceeds of the sale of forest products from a contract harvesting sale must be deposited into this account and must be retained in the account to be used to pay for all contract harvesting costs, as provided in subsection (2).

(2) Expenditures may be credited against the account for contract harvesting costs. Personnel services costs for state employees may not be credited against the account.

(3) An amount equal to the contract harvesting costs must be retained in the account and must be deducted from the gross proceeds to determine the net proceeds. The net proceeds from the sale of the forest products must be distributed to the appropriate trust.

(4) An initial account balance must be created by transferring up to \$500,000 into the contract harvesting account from the timber sale account.

(5) If the contract harvesting program is terminated or discontinued for more than 10 years, any balance remaining in the contract harvesting account in excess of \$500,000 must be distributed to the appropriate trust. The remaining balance up to \$500,000 must be transferred back to the timber sale account provided for in 77-1-613.

Section 8. Section 77-1-613, MCA, is amended to read:

"77-1-613. Deduction of portion of income received from sale of timber from state trust lands -- creation of account. (1) There is an account in the state special revenue fund called the state timber sale account. Money in the account may be appropriated by the legislature for use by the department in the manner set out in this section to enhance the revenue creditable to the trusts. There must be placed in the account an amount from timber sales on state lands each fiscal year equal to the amount appropriated from the account for the corresponding fiscal year.

(2) Timber sale program funds deducted under subsection (1) must be directly applied to timber sale preparation, and timber sale documentation, and contract harvesting costs as provided in [section 6].

(3) In order to increase the volume of timber sold at the earliest possible time while continuing to meet the requirements of applicable state and federal laws and in order to avoid unnecessary delays and extra costs that would result from increasing its permanent staff, the department may contract for services that will enable

achievement of the purposes of this section and that will achieve the highest net return to the trusts.

(4) To maximize overall return to the trusts, the timely salvage of timber must be considered. However, salvage timber sales may not adversely affect the implementation of green timber sales programs."

Section 9. Section 77-5-201, MCA, is amended to read:

"77-5-201. Sale of timber. (1) Under the direction of the board, the department may sell the timber crop and other crops of the forests after examination, estimate, appraisal, and report and under any rules established by the board. Timber or forest products sold from state trust lands may be sold by a stumpage method or a lump-sum method or marketed by the state through contract harvesting as provided in [sections 1 through 6].

(2) Timber proposed for sale in excess of 100,000 board feet must be advertised in a paper of the county in which the timber is situated for a period of at least 30 days, during which time the department must receive sealed bids up to the hour of the closing of the bids, as specified in the notice of sale.

(3) (a) In cases of emergency ~~due to~~ because of fire, insect, fungus, parasite, or blowdown or to address forest health concerns or in cases when the department is required to act immediately to take advantage of access granted by permission of an adjoining landowner, timber proposed for sale not in excess of 1 million board feet may be advertised by invitation to bid for a period of not less than 10 days. The department may reject any ~~or all~~ bids, upon approval of the board, or it shall award the sale to the highest responsible bidder.

(b) (i) In cases when the department is required to act immediately to take advantage of access granted by permission of an adjoining landowner and there is only one potential buyer with legal access, the department may negotiate a sale of timber not in excess of 1 million board feet without offering the timber for bid if the sale is for fair market value.

(ii) The provisions of subsection (3)(b)(i) do not apply to situations when the only access is totally controlled by a potential purchaser of the timber, in which case the department shall seek to negotiate permanent, reciprocal access.

(c) In the situations described in subsections (3)(a) and (3)(b)(i), the department is not required to comply with the provisions of 75-1-201(1) to the extent that compliance is precluded by limited time available to take advantage of the sales opportunities described by this subsection (3)."

Section 10. Section 77-5-204, MCA, is amended to read:

"77-5-204. Sale of timber -- fee for forest improvement. (1) The board may sell timber on state lands; ~~at a price per 1,000 board feet, when appropriate, that, or~~ other forest products removed from state lands, as provided in [sections 1 through 6], ~~at a per unit price when,~~ in the board's judgment, it is in the best interest of the state, provided that live timber is not sold for less than full market value.

(2) Timber sold or cut from state lands must be cut and removed under rules that may be prescribed by the board for standing timber preservation and fire prevention. In all cases, the board shall require the person cutting the timber to pile and burn or otherwise dispose of the brush and slash in the manner that may be prescribed by the board.

(3) Before the sale of timber is granted, the value of the timber must be appraised under the direction of the department, upon the request and subject to the approval of the board. An appraisal must show as nearly as possible the per unit value ~~per 1,000 board feet, when appropriate, of all merchantable timber forest products.~~

(4) In addition to the price of the timber forest products established under subsection (1), the board may require a timber or other forest product purchaser to pay a fee for forest improvement. Revenue from the fee must be deposited in the state special revenue fund to the credit of the department and, as appropriated by the legislature, may be used only for:

(a) disposing of logging slash;

- (b) acquiring access and maintaining roads necessary for timber harvesting on state lands;
- (c) reforestation, thinning, and otherwise improving the condition and income potential of forested state lands; and
- (d) complying with legal requirements for timber harvesting."

NEW SECTION. **Section 11. Severability.** If a part of [this act] is invalid, all valid parts that are severable from the invalid part remain in effect. If a part of [this act] is invalid in one or more of its applications, the part remains in effect in all valid applications that are severable from the invalid applications.

NEW SECTION. **Section 12. Codification instruction.** [Sections 1 through 6] are intended to be codified as an integral part of Title 77, chapter 5, part 2, and the provisions of Title 77, chapter 5, part 2, apply to [sections 1 through 6].

NEW SECTION. **Section 13. Effective date.** [This act] is effective on passage and approval.

- END -

Appendix B: Contributors to the HJR 33 White Paper

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Chuck Roady, F. H. Stoltz L & L Co.

Dave Richards, Washington Dept. of Natural Resources

Bob Dick, American Forest Resource Council

Terry Thorpe, Montana Dept. of Natural Resources and Conservation

Brian Robbins, Montana Dept. of Natural Resources and Conservation

Shawn Thomas, Montana Dept. of Natural Resources and Conservation

Paul Engelman, Montana Dept. of Natural Resources and Conservation

Tom Schultz, Montana Dept. of Natural Resources and Conservation

David Groeschl, Montana Dept. of Natural Resources and Conservation

Roger Ziesak, Montana Dept. of Natural Resources and Conservation

Appendix C

59th Legislature

HJ0033



A JOINT RESOLUTION OF THE SENATE AND THE HOUSE OF REPRESENTATIVES OF THE STATE OF MONTANA REQUESTING AN INTERIM STUDY OF ISSUES RELATED TO CONTRACT HARVESTING OF TIMBER FROM SCHOOL TRUST LANDS.

WHEREAS, the Montana Constitution requires that school trust lands be managed for the support and benefit of various state educational institutions; and

WHEREAS, the Department of Natural Resources and Conservation estimates that authorizing the department to sell logs directly from state lands could increase funding available for trust beneficiaries by as much as 30% over the current method of timber sales; and

WHEREAS, the Washington Department of Natural Resources manages a program that allows contract harvesting on state lands for up to 10% of the total annual volume of timber offered for sale; and

WHEREAS, legislation that would have authorized a similar program in Montana passed the Senate by a 48-2 vote.

NOW, THEREFORE, BE IT RESOLVED BY THE SENATE AND THE HOUSE OF REPRESENTATIVES OF THE STATE OF MONTANA:

That the Legislative Council be requested to designate an appropriate interim committee, pursuant to section 5-5-217, MCA, or direct sufficient staff resources to examine issues surrounding the possible implementation of a contract harvesting program for state lands in Montana, including but not limited to an examination of similar programs in other states, standards for log quality, accounting practices, standards for hiring loggers, stewardship contracting, revenue and expenses, and economic impacts to the logging industry.

BE IT FURTHER RESOLVED, that participants in the study include representatives of the Department of Natural Resources and Conservation, beneficiaries of trust lands, the Montana Logging Association, the Montana Wood Products Association, and the conservation community.

BE IT FURTHER RESOLVED, that if the study is assigned to staff, any findings or conclusions be presented to and reviewed by an appropriate committee designated by the Legislative Council.

BE IT FURTHER RESOLVED, that all aspects of the study, including presentation and review requirements, be concluded prior to September 15, 2006.

BE IT FURTHER RESOLVED, that the final results of the study, including any findings, conclusions, comments, or recommendations of the appropriate committee, be reported to the 60th Legislature.

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